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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION  
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF  
ARIZONA-AMERICAN WATER COMPANY,  
AN ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE CURRENT FAIR  
VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND FOR INCREASES IN ITS  
RATES AND CHARGES BASED THEREON  
FOR UTILITY SERVICE BY ITS PARADISE  
VALLEY WATER DISTRICT

DOCKET NO. W-01303A-05-0405

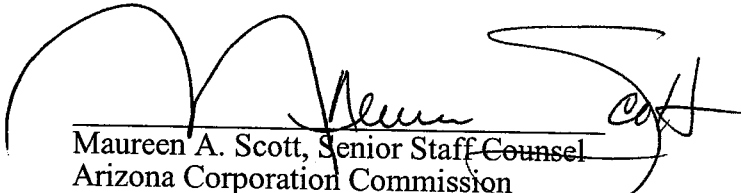
IN THE MATTER OF THE APPLICATION OF  
OF ARIZONA-AMERICAN WATER  
COMPANY, INC., AN ARIZONA  
CORPORATION,  
FOR APPROVAL OF AN AGREEMENT  
WITH THE PARADISE VALLEY COUNTRY  
CLUB

DOCKET NO. W-01303A-05-0910

**NOTICE OF FILING**

Staff of the Arizona Corporation Commission ("Commission") hereby files the Direct  
Testimony of Darron W. Carlson of the Utilities Division, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 25<sup>th</sup> day of April, 2008.

  
Maureen A. Scott, Senior Staff Counsel  
Arizona Corporation Commission  
Legal Division  
1200 West Washington Street  
Phoenix, Arizona 85007  
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Arizona Corporation Commission

**DOCKETED**

APR 25 2008

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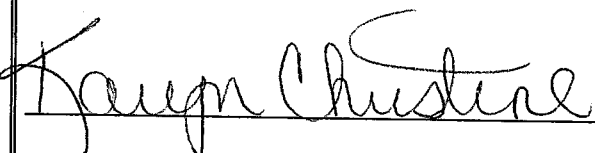
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**DIRECT**

**TESTIMONY**

**OF**

**DARRON W. CARLSON**

**DOCKET NOS. W-01303A-05-0405 AND  
W-01303A-05-0910**

**IN THE MATTER OF THE APPLICATIONS OF  
ARIZONA-AMERICAN WATER COMPANY,  
INC., AN ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE CURRENT FAIR  
VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND FOR CHARGES BASED  
THEREON FOR UTILITY SERVICE BY ITS  
PARADISE VALLEY WATER DISTRICT AND  
FOR APPROVAL OF AN AGREEMENT WITH  
THE PARADISE VALLEY COUNTRY CLUB**

**APRIL 25, 2008**

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
JEFF HATCH-MILLER  
Commissioner  
KRISTIN K. MAYES  
Commissioner  
GARY PIERCE  
Commissioner

IN THE MATTER OF THE APPLICATIONS OF )  
ARIZONA-AMERICAN WATER COMPANY, )  
INC., AN ARIZONA CORPORATION, FOR A )  
DETERMINATION OF THE CURRENT FAIR )  
VALUE OF ITS UTILITY PLANT AND )  
PROPERTY AND FOR CHARGES BASED )  
THEREON FOR UTILITY SERVICE BY ITS )  
PARADISE VALLEY WATER DISTRICT AND )  
FOR APPROVAL OF AN AGREEMENT WITH )  
THE PARADISE VALLEY COUNTRY CLUB )  
\_\_\_\_\_ )

DOCKET NOS. W-01303A-05-0405  
W-01303A-05-0910

RECONSIDERATION OF  
DECISION NO. 68858 PURSUANT  
TO A.R.S. § 40-252 FOR THE  
LIMITED PURPOSE OF  
REVIEWING THE RATE DESIGN  
AGREEMENT

DIRECT

TESTIMONY

OF

DARRON W. CARLSON

PUBLIC UTILITIES ANALYST MANAGER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

APRIL 25, 2008

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**EXECUTIVE SUMMARY**  
**ARIZONA-AMERICAN WATER COMPANY, INC., -**  
**PARADISE VALLEY WATER DISTRICT**  
**DOCKET NOS. W-01303A-05-0405 AND W-01303A-05-0910**

Arizona-American Water Company, Inc., - Paradise Valley Water District ("PVWD" or "Company") is a Class A water utility. PVWD serves approximately 4,725 residential customers and 25 commercial customers in portions of the Town of Paradise Valley, City of Scottsdale, and unincorporated Maricopa County.

This case arises from the Commission's Decision No. 68858 issued on July 28, 2006, in PVWD's last rate case, Docket No. W-01303A-05-0405. Subsequent to that date, concerns were raised by the Town of Paradise Valley ("Town"), several resorts and Paradise Valley residents regarding the combined impact of the various surcharges. As a result, the Town indicates that there have been numerous discussions, meetings, and filings regarding the following two surcharges: 1) the High Block Usage Surcharge and 2) the Public Safety Surcharge. On January 16, 2008, the Town submitted a proposed Rate Design Agreement ("Agreement"). Other signatories to the Agreement included the Camelback Inn, Sanctuary on Camelback Mountain, Renaissance Scottsdale Resorts, Camelhead Estates II Housing Association, Clearwater Hills Improvement Association, and Finisterre HOA (collectively "Petitioning Parties"). On February 27, 2008, the Commission voted to reconsider Decision No. 68858 pursuant to A.R.S. §40-252.

On March 14, 2008, a Procedural Order was issued requiring the Petitioning Parties to file testimony supporting the Agreement. The Agreement requests that the Commission reduce the High Block Surcharge from the current \$2.15 per 1,000 gallons of usage to \$1.00 per 1,000 gallons of usage. It also requests elimination of the current Public Safety Surcharge which is set at \$1.00 per 1,000 gallons of usage. Additionally, the Agreement requests that a new Public Safety Surcharge be implemented in the future in Arsenic Cost Recovery Mechanism ("ACRM") step like fashion. The Agreement also requests changing the accounting treatment of funds received from the Public Safety Surcharge after March 1, 2008, from "contributions" to "revenues".

If the Commission desires to give the Petitioning Parties some interim relief until PVWD's next rate case, Staff recommends, that the Commission grant the Petitioning Parties' request to reduce the High Block Usage Surcharge to \$1.00 per 1,000 gallons of usage. Staff also recommends that the Commission grant the Petitioning Parties' request to eliminate the current Public Safety Surcharge.

However, Staff recommends, that at this time, the Commission deny the Petitioning Parties' requests to implement a future Public Safety Surcharge in ACRM step like fashion and to account for the funds as "revenues" rather than "contributions". The Company has stated that it will be filing a new rate case for PVWD in the next month, and Staff believes that it is more appropriate to examine future surcharges and their accounting treatment in that case.

1     **INTRODUCTION**

2     **Q.     Please state your name, occupation, and business address.**

3     A.     My name is Darron W. Carlson. I am a Public Utilities Analyst Manager employed by the  
4           Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division  
5           ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

6  
7     **Q.     Briefly describe your responsibilities as a Public Utilities Analyst Manager.**

8     A.     In my capacity as a Public Utilities Analyst Manager, I supervise analysts who examine,  
9           verify, and analyze utilities' statistical, financial, and other information. These analysts  
10          write reports and/or testimonies analyzing proposed mergers, acquisitions, asset sales,  
11          financings, rate cases, and other matters in which they make recommendations to the  
12          Commission. I provide support and guidance along with reviewing and editing the work  
13          products. I also perform analysis as needed on special projects. Additionally, I provide  
14          expert testimony at formal hearings. Finally, I assist Staff members during formal  
15          hearings and supervise responsive testimonies, as needed during the hearing process.

16  
17    **Q.     Please describe your educational background and professional experience.**

18    A.     I hold Bachelor of Arts degrees in both Accounting and Business Management from  
19           Northeastern Illinois University in Chicago, Illinois. I have participated in many seminars  
20           and workshops related to utility rate-making, cost of capital, and similar issues. These  
21           seminars have been sponsored the National Association of Regulatory Utility  
22           Commissioners ("NARUC"), Duke University, Florida State University, Michigan State  
23           University, New Mexico State University, and various other organizations. I have led or  
24           actively participated in more than 125 cases before this Commission over the last  
25           seventeen years. Since my promotion to management, I have supervised analysts involved  
26           in more than 150 additional cases before this Commission.

1     **Q.     What is the scope of your testimony in this case?**

2     A.     I am presenting Staff's analysis regarding the proposed Rate Design Agreement  
3             ("Agreement") that was originally filed by the Town of Paradise Valley ("Town") on  
4             January 16, 2008.

5  
6     **Q.     Are other members of Staff presenting testimony in this proceeding?**

7     A.     No.  
8

9     **BACKGROUND**

10    **Q.     What is the purpose of this proceeding?**

11    A.     This proceeding was a result of the Commission's decision to reconsider, pursuant to  
12             A.R.S. §40-252, the rate design approved by the Commission in Decision No. 68858, the  
13             last PVWD rate case. Decision No. 68858 was issued on July 28, 2006. On September  
14             28, 2007, the Town submitted to the Commission, Town Resolution No. 1156 that  
15             requested reconsideration of the "High Block" and "Public Safety" Surcharges for the  
16             Arizona-American Water Company ("Arizona-American") Paradise Valley Water District  
17             ("PVWD") approved in Commission Decision No. 68858. Since that time, the Town has  
18             had numerous meetings with Town residents (including some of the larger homeowners'  
19             associations) and the resorts within the Town affected by the Decision to see if a  
20             consensus rate design could be negotiated among these groups. On January 6, 2008, the  
21             Petitioning Parties filed the Agreement with the Commission and requested  
22             reconsideration of Decision No. 68858.

23  
24             After the Commission decided to reconsider the PVWD rate design, on March 14, 2008, a  
25             Procedural Order was issued requiring the Petitioning Parties to file Direct Testimony



1 regarding the Agreement on March 28, 2008, and requiring Responsive Testimony on  
2 April 25, 2008. On March 28, 2008, the Resorts and the Town filed Direct Testimony.  
3

4 **AGREEMENT**

5 **Q. Who or what parties participated in creating the Agreement filed by the Town?**

6 A. Along with the Town, group participants and Petitioning Parties included the Camelback  
7 Inn, Sanctuary on Camelback Mountain, and the Renaissance Scottsdale Resort,  
8 collectively the "Resorts"; also Camelhead Estates II Home Owner's Association  
9 ("HOA"), Clearwater Hills Improvement Association, and Finisterre HOA. All of the  
10 aforementioned were signatories to the Agreement. Although PVWD participated in the  
11 creation of it, PVWD did not sign the Agreement.  
12

13 **Q. What events led to the Agreement?**

14 A. Town Witness Mary Hamway, an elected member of the Town's Council, stated that  
15 Town officials received complaints from frustrated residents who were surprised by the  
16 impact of the first Surcharge. She stated that the Agreement rectifies in part: 1) the  
17 unintended consequences of placing the resorts within the Town at a competitive  
18 disadvantage when compared to resorts that are not within the Arizona-American Paradise  
19 Valley Service Area; and 2) the significant and unexpected rate increases incurred by  
20 Town residential users.  
21

22 **Q. Did the Town or Resorts participate as Intervenor in the Proceeding before the**  
23 **Commission?**

24 A. Witness Hamway stated that the Town withdrew its Motion to Intervene because the  
25 Town Council did not have a full understanding of the value of serving as an Intervenor.  
26 Ms. Hamway stated that the Town should not have withdrawn its Motion to Intervene.

1        Soon after the receipt of the Commission's July 28, 2006 Decision, the Town realized  
2        there were significant unintended consequences for the resorts located in Paradise Valley  
3        and unexpected impacts to the residents as a result of the "High Block" Surcharge and the  
4        "Public Safety" Surcharge.

5  
6        The Resorts chose not to intervene.

7  
8        **Q.    Why Is the Town advocating the particular rate restructuring that it has proposed in**  
9        **the Agreement?**

10      A.    Town Witness Hamway stated that a review of the water charges incurred by Paradise  
11      Valley resorts under Decision No. 68858 compared to the water charges of Phoenix and  
12      Scottsdale resorts allowed Town officials to conclude that the resorts within the Paradise  
13      Valley Water District are paying significantly more for their water than their nearby  
14      competitors. This results in an increase in their room rates which places them at a  
15      competitive financial disadvantage. Ms. Hamway further stated that the operational  
16      success of the resorts within the Town is an essential element of the Town's economic  
17      viability and sustainability.

18  
19      She also stated that the proposal is fair because the "high block" non-commercial residents  
20      in the PVWD perceive that the "high block" rate increase was implemented without  
21      sufficient notice and inequitably requires only the "high block" users (only 20% of  
22      PVWD's customer base) to pay for the bulk of the fire-flow improvements.

23  
24      Finally, she states that this interim relief will allow the Town further time to review,  
25      discuss, and implement meaningful water conservation measures intended to strongly  
26      encourage "high block" residential customers to conserve water.

1     **Q.     What lead to the initial rate design adopted in Decision No. 66858?**

2     A.     Staff notes that these surcharges were created to address two issues that PVWD was  
3           experiencing at the time of the instant rate case. The Public Safety Surcharge was created  
4           to help PVWD fund the expensive fire flow projects the Town sought to put in place.  
5           PVWD had stated that with the Public Safety Surcharge, the fire flow project would be  
6           delayed. For this reason, it also allowed use of the High Block Usage Surcharge to fund  
7           the fire flow projects. In addition, The High Block Usage Surcharge was created to  
8           encourage water conservation in the high-use PVWD by transferring more costs to the  
9           high users in the system. The Commission, in Decision No. 68858, allowed use of the  
10          High Block Usage Surcharge for the period of construction of the fire flow projects only.  
11          It also ordered the automatic end to the Public Safety Surcharge once the fire flow projects  
12          were completed. The funds from the High Block Usage Surcharge were then to be used to  
13          fund other PVWD projects.

14  
15     **Q.     Please explain what or how the Agreement would alter Decision No. 68858.**

16     A.     The Agreement provides for a reduction of the High Block Usage Surcharge from its  
17           current \$2.15 per 1,000 gallons of usage to \$1.00 per 1,000 gallons of usage, and to  
18           continue to account for the proceeds as Contributions in Aid of Construction ("CIAC"). It  
19           would recover all unrecovered fire-flow costs incurred as of February 29, 2008, if any,  
20           including Commission authorized accounting costs deferrals.

21  
22           Further, the Agreement requests the elimination of the current Public Safety Surcharge  
23           which is \$1.00 per 1,000 gallons of usage. The Agreement further proposes that the  
24           Public Safety Surcharge be reestablished in the future in a step-like fashion similar to an  
25           Arsenic Cost Recovery Mechanism ("ACRM"). The Petitioning Parties propose that all

1 the various ACRM conditions required by the Commission in its previous orders apply as  
2 well.

3  
4 The Commission would use the finding of fair value in Decision No. 68858 to determine  
5 fair value of subsequent step increases, as it does with the ACRM. The Public Safety  
6 Surcharge would continue to apply only to the commodity portion of the rate. The first  
7 step increase filing is anticipated in late 2008 upon completion of Phase 3 of Paradise  
8 Valley's fire-flow project already under construction. The proposed Public Safety  
9 Surcharge would recover investments made after March 1, 2008, under a revenue  
10 requirements formula rather than CIAC.

11  
12 For fire flow phases completed after March 1, 2008, the Public Safety Surcharge would be  
13 designed to recover 50 percent of the investment. The revised High Block Surcharge  
14 would recover the remaining 50 percent until a final order is effective in PVWD's next  
15 rate case.

16  
17 Ralph Scatena, the witness on behalf of the Resorts, testified that the Agreement includes  
18 a consensus rate design which would act as an interim solution pending the next rate case.  
19 He further states that it results in immediate and needed rate relief for all effected  
20 ratepayers, including the Resorts.

21  
22 **Q. Does the Agreement only affect the Resorts?**

23 **A.** No. While the Agreement is being sponsored or proposed by the Town and the Resorts, as  
24 well as several HOAs, it also would provide relief to all high block customers, including  
25 residential.

1     **Q.     What is Staff's assessment in general of the results of the Agreement?**

2     A.     The Petitioning Parties have obviously put a lot of time into the Agreement. Moreover, it  
3           appears that they have sought to achieve consensus among the stakeholders, which was  
4           important to the Commission, if reconsideration was granted.

5  
6           If the Commission believes that some interim rate relief is appropriate at this time, then  
7           there are portions of the Agreement that Staff would support. Further, PVWD does not  
8           object to the proposed reduction in the surcharges at this time. Staff thus, in general,  
9           believes the Agreement should be given serious consideration by the Commission. The  
10          testimony of both the Town and Resorts raise some compelling points in favor of portions  
11          of the Agreement. But the Commission should defer some of the proposals in the  
12          Agreement to the Company's soon to be filed rate case.

13  
14    **Q.     What points did the Town and Resorts make in their testimony that Staff believe**  
15          **favor some relief at this time?**

16    A.     Resort witness Scatena states that the Camelback Inn's water rates have gone up  
17           approximately 220%, or an additional \$220,620 per year. The Resorts believe that the  
18           current High Usage Surcharge ("HUS") conservation threshold for commercial customers  
19           which was set at 400,000 gallons per month, is arbitrary and unfairly penalizes the  
20           Resorts. The Resorts minimum needs far exceed 400,000 gallons per month. In contrast,  
21           the residential threshold was set at 80,000 gallons per month. Both of these thresholds  
22           were proposed by the Company. Thus the threshold for resorts is set at the equivalent of  
23           only 5 residential homes. The Camelback Inn covers 188 acres, while a typical residential  
24           home in the PVWD covers one acre.

25

1           Witness Scatena also states that the second tier amount of 400,000 gallons, based upon the  
2           Resorts' water usage patterns, will not promote any additional significant conservation  
3           and is therefore a purely punitive charge. Moreover, the Resorts argue that they have  
4           undertaken considerable conservation efforts: replacing high water use plants and grass  
5           with xeriscape landscaping; upgrading and improving irrigation management systems and  
6           infrastructure; minimizing water use through efficient delivery systems and prudent water  
7           conservation policies; and seasonal and climactic adjustment. They also state that they  
8           continue to examine ways to improve conservation.

9  
10       **Q.    Why shouldn't the Commission just wait to reexamine this issue when the Company**  
11       **files its next rate case?**

12       A.    Mr. Scatena, testified that the Resorts need the relief now and the process for litigating a  
13           rate case can be in excess of one year. If an interim solution is approved, it would also be  
14           most beneficial for the Resorts if the new rate design was implemented prior to the high  
15           water usage summer months.

16  
17           Finally, Town witness Hamway states that less revenue from Resorts, if they are  
18           competitively disadvantaged, will ultimately harm the Town. She also indicates that High  
19           Block Users believe they are unfairly bearing most of the fire flow expense.

20  
21       **Q.    Does Staff agree with all of the provisions of the proposed Agreement?**

22       A.    No.

1    **Q.    Does Staff agree with the proposal in the Agreement to reduce the High Block**  
2           **Surcharge and eliminate the Public Safety Surcharge until the Commission's Order**  
3           **in the next rate case?**

4    **A.    Yes. Staff agrees with these recommendations. However, this should not preclude**  
5           **reexamination of the issues in the next rate case, to the extent desired.**

6  
7    **Q.    If the High Block Surcharge is reduced and the Public Safety Surcharge is**  
8           **eliminated, how do the Petitioning Parties propose to make up for this reduction in**  
9           **the Company's revenues?**

10   **A.    That is not addressed in the proposed Agreement. However, the Company participated in**  
11           **its formulation, and it is Staff's understanding that the Company is in agreement with the**  
12           **proposed reductions. Additionally, the Company intends to immediately file another rate**  
13           **case, wherein this issue will be looked at again.**

14  
15   **Q.    What is Staff's assessment of the Agreement's request to alter the future funding of**  
16           **fire flow phases completed after March 1, 2008?**

17   **A.    Staff believes that it is inappropriate to entertain these types of alterations to the prior**  
18           **Decision at this time. Staff recommends that all issues other than the**  
19           **reduction/elimination of surcharges be addressed in the Company's next rate case which it**  
20           **has indicated it will be filing shortly.**

21  
22   **Q.    So is it correct that Staff does not support a predetermination with respect to a new**  
23           **ACRM-like Public Safety Surcharge in this proceeding?**

24   **A.    Correct. The Parties may advocate their positions in the next rate case. Nothing should be**  
25           **predetermined in this proceeding to limit or preempt the Commission's rate options in the**  
26           **next rate case. A future rate proceeding that allows for a comprehensive and full**

1 consideration of all options is the appropriate vehicle for deciding any possible alternate  
2 rate treatment of the high block surcharge collections.

3  
4 The case has been reopened to specifically deal with the need for interim rate relief and  
5 Staff believes that the Agreement goes beyond this rate issue when it addresses the design  
6 of a future Public Safety Surcharge. Staff believes it would be inappropriate, even if  
7 PVWD was not going to be filing a new rate case within weeks or months of the filing of  
8 this testimony. Staff believes any new or recreated rate treatment of the Public Safety  
9 Surcharge needs to be reevaluated in its entirety and not dealt with, in part, in this  
10 proceeding. PVWD needs to reestablish its requirements and goals in its new rate case, so  
11 that this Commission can properly evaluate the alternatives. The Town and Resorts can  
12 intervene in that new proceeding so their issues can be raised and considered by the  
13 Commission. Staff hopes that all parties now realize the importance of intervening in  
14 cases before the Commission so all the issues of concern can be adequately presented by  
15 the parties and thereby considered by the Commission.

16  
17 **Q. What is Staff's assessment of the Agreement's proposal to reclassify monies received**  
18 **from "contributions" to "revenues".**

19 **A.** The Agreement provides for the Parties to seek to complete the transition of the High  
20 Block Surcharge from "contributions in aid of construction" to a "revenue-requirement  
21 formula" in PVWD's next rate case. It also propose that the Public Safety Surcharge  
22 would recover investments made after March 1, 2008, under a revenue requirements  
23 formula. Staff does not believe that it is appropriate to alter at this time, the  
24 characterization of the funds as "contributions" or "revenues". That is more properly  
25 addressed in PVWD's next rate case.



1     **RECOMMENDATIONS**

2     **Q.     What are Staff's recommendations?**

3     A.     Staff recommends, that if the Commission desires to give some interim relief to the High  
4           Usage customers and the resorts, the Commission grant the Petitioning Parties' request to  
5           reduce the High Block Surcharge to \$1.00 per 1,000 gallons of usage and to eliminate the  
6           current Public Safety Surcharge, for the interim period until the Commission reexamines  
7           this issue in the Company's next rate case.

8  
9           Staff further recommends that the Commission deny the Petitioning Parties' request to  
10          design a future Public Safety Surcharge at this time. In addition, Staff recommends that  
11          the Commission not approve a reclassification of the funds from the Public Safety  
12          Surcharge from "contributions" to "revenues" at this time.

13  
14    **Q.     Does this conclude your Direct Testimony?**

15    A.     Yes, it does.